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No. 88-157

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

NATIONWIDE MUTUAL INSURANCE COMPANY,
Petitioner,

v.

HENRY GERRARD CLAY,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Alabama

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BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the refusal of the Alabama Supreme Court to address petitioner's constitutional challenges to the imposition of punitive damages—on the ground that the challenges had not been raised before trial court —constitutes an adequate, independent state ground supporting the judgment.

2. Whether the due process clause requires disqualification of judges with no personal interest in the case because they once considered the case with a judge who was later disqualified.

3. Whether the Alabama Supreme Court was prohibited by a prior order of this Court—which made no mention of the issue—from applying a state statute that imposed a penalty on unsuccessful appellants.

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STATEMENT

Respondent in this case was awarded damages of $46,165 for breach of contract and $1,250,000 for a bad faith refusal to pay his insurance claim. The Alabama Supreme Court affirmed the judgment in 1985, but this Court vacated that affirmance and remanded the case for reconsideration in light of the decision in *Aetna Life Ins. Co. v. Lavoie*, 106 S.Ct. 1580 (1986). After full rebriefing and reargument, the Alabama Supreme Court again affirmed the judgment.

The relevant facts are largely set forth in the most recent opinion of the Alabama Supreme Court. Pet. App. 1b-11b. They show that, in early 1977, respondent, then a practicing lawyer, took out an insurance policy with petitioner to provide him with income in the event that he became disabled. Prior to issuing the policy, petitioner required respondent to undergo a physical examination by a designated physician. That doctor gave respondent a "clean bill of health." Pet. App. 2b-3b.[1]

About seven months later, respondent found that he was having difficulty in reading. He was examined by a Dr. Ross, his regular optometrist, who determined that he was suffering from cataracts. Pet. App. 3b. That diagnosis was thereafter confirmed by a Dr. Harrison. In addition, Dr. Harrison told respondent that the condition would become worse and that respondent would eventually go blind. Pet. App. 4b. Confronted by that information, respondent closed his law office. Pet. App. 4b.

Respondent then began his extensive efforts to obtain payment under his policy with petitioner, while petitioner began the series of actions resulting in the verdict of bad faith. To begin with, respondent had repeated difficulty in reaching the examiner in charge of his claim and, when he was able to do so, was given a "run around." Pet. App. 4b. In addition, respondent was falsely told that documents were missing from his file; at other times, petitioner's employees apparently did not even bother to look for necessary papers, indicating (erroneously) that they had not been received. Pet. App. 4b.

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[1] Respondent had previously been covered by a disability policy issued by another company (Paul Revere Insurance Co.). Pet. App. 2b. He contacted Paul Revere to cancel that policy, but its agent convinced him to take out a new policy, stating that the company would cancel the old policy and incorporate it into the new one. Pet. App. 3b. Subsequent attempts by respondent to reach petitioner's agent proved unavailing because the agent had been promoted and transferred to a different town. *Id.* The policy with petitioner thus remained in force as well.

Petitioner also raised obstacles to respondent's proof of disability. First, it declined to accept the report of Dr. Harrison as such proof, insisting that Dr. Ross had to file the physician's report. R. 98, 489.[2] Dr. Ross did so, but petitioner also decided that respondent would have to be examined by yet a third doctor, this time one of its choosing. That doctor, a Dr. Rencher, also concluded that respondent had a "disability . . . due solely to cataracts." Pl. Ex. 38.

Although petitioner eventually conceded that respondent was disabled, it still did not honor his claim. Rather, it took the position that the condition had existed before issuance of the policy. Pet. App. 4b. At that time, petitioner had in its files the report from Dr. Ross indicating that this charge was unfounded. Moreover, while it was refusing to pay benefits to respondent, petitioner continued to demand premiums under the policy, even though respondent was unable to work and the policy provided for a waiver of premiums in the event of disability. Pet. App. 5b.

Petitioner ultimately abandoned its theory of preexisting condition as well, but it did not abandon its refusal to honor the policy. Its new tack was an assertion that respondent had made misrepresentations on his application. Petitioner thus continued to demand further information about the representations, including requests for tax returns that it knew respondent did not have. When respondent raised the possibility of filing suit to obtain the benefits, a lawyer for petitioner answered: "Go ahead, but you won't receive one nickel for ten years." Pet. App. 5b.

Respondent finally did file suit for breach of contract in July 1978, almost one year after he had become disabled. He later amended the complaint to add a claim

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[2] The designation "R" refers to the record on appeal before the Alabama Supreme Court.

for bad faith refusal to pay.[3] At trial, the judge directed a verdict for respondent on the breach of contract claim and submitted the claim of bad faith to the jury. The jury awarded petitioner $1,250,000 in punitive damages.[4]

Petitioner filed several post-trial motions but raised no federal claims at all. Nor did it raise any federal claims in its briefs on appeal. Its challenges to the judgment in both instances rested solely on state law grounds.

The Alabama Supreme Court, by a 6-3 margin, affirmed the judgment in its entirety. *Nationwide Mutual Ins. Co. v. Clay*, 469 So. 2d 533 (Ala. 1985). Noting "the evidence of [petitioner's] seriatim assertions of grounds for denying coverage, which were not supported by the facts and documents before [its employees], but only by their assumptions," the court concluded that the jury had sufficient grounds of bad faith on which to base its award. *Id.* at 546. The court further declined to grant a remittitur, observing that "the repeated unjustified denials of [respondent's] valid claim constitute the very type of claims handling which the bad faith action is designed to prevent." *Id.*

Petitioner unsuccessfully sought rehearing, arguing that Justice Embry, one of the six judges voting to affirm the judgment, should have disqualified himself because of his role as a plaintiff in other bad faith suits.[5] Peti-

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[3] Prior to that time petitioner had made four payments, amounting to slightly more than $5,000.00, but continued to question the validity of the claim and to insist upon premium payments despite the provisions for waiver. Pet. App. 5b, 8b.

[4] Petitioner did not suggest that the court's instruction on punitive damages was constitutionally inadequate, nor did it suggest an alternate instruction.

[5] In this submission petitioner also raised, for the first time, a federal challenge to the judgment on the bad faith claim. Its argument, however, was limited to the contention that the tort of bad faith had been applied retroactively to its conduct. (This argument

tioner raised the same claim in a petition for certiorari to this Court.[6] After this Court held in *Aetna Life Ins. Co. v. Lavoie, supra*, that Justice Embry should have disqualified himself in cases of this sort, it vacated the judgment in this case and remanded for further consideration. 476 U.S. 101 (1986).

The Alabama Supreme Court then asked the parties to rebrief and reargue the case.[7] Having heard reargument, it affirmed the judgment in its entirety. With regard to petitioner's state-law arguments, the court found ample evidence to support the charge of bad faith, pointing out that petitioner's original ground of resistance—that respondent was not disabled—"was directly contradicted by several doctors' reports (which were shown to be in the hands of [petitioner] when it denied the claim) . . . ." Pet. App. 9b. It also noted that petitioner had made the charge of a pre-existing condition despite having "in its possession a report showing that this was not the case," *id.*, and that petitioner had followed it up with "a frivolous position" that respondent was required to undergo surgery in order to mitigate his damages. *Id.* It emphasized that "[t]he tort of bad faith was recognized to deal with just this sort of situation." Pet. App. 10b.

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is reprinted at pages 91a-92a of the Appendix to the earlier Petition For Writ of Certiorari, No. 84-1942).

[6] Petitioner also expanded the federal attacks upon the judgment itself, first raising the argument that the amount of the award was unconstitutional. *See* Petition for Writ of Certiorari, No. 84-1942, at 15-16.

[7] After remand, petitioner initially asked that all judges hearing the first appeal be disqualified. It did not, however, urge the point in its briefs.

Five judges (Jones, Almon, Shores, and Adams, JJ., with Beatty, J., specially concurring) voted to affirm. Justice Maddox dissented. Three judges (Tolbert, C.J., Houston, and Steagall, JJ.) did not participate.

The court refused to address petitioner's federal claims, basing its refusal on the fact that they had not been raised in accordance with state procedural rules. Pet. App. 10b. Remarking that "these challenges were not presented for resolution before the trial court and have been presented for the first time on appeal," the court found that "[r]esolution of these issues would violate a fundamental principle of appellate jurisdiction: that issues not raised before the trial court may not be raised on appeal." *Id.*, *citing Green v. Taylor*, 437 So. 2d 1259 (Ala. 1983).[8]

ARGUMENT

The petition in this case presents no issue warranting review by this Court. The constitutional arguments attacking the award of punitive damages were not raised in timely fashion below, and the Alabama Supreme Court, applying standard rules of state appellate procedure, refused to consider them. The resolution of those claims thus rests entirely upon state law, as does the question whether a since-repealed state statute, penalizing an unsuccessful appellant, is applicable to this case. With regard to the one federal claim actually at issue here, petitioner's argument is simply meritless: due process does not require disqualification of judges with no personal interest in a case, merely because they discussed the case with a judge who was later disqualified.

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[8] Although the court did not discuss the issue in its opinion affirming the judgment, it later made clear that, under state law, petitioner was required to pay the 10 percent "damages and interest" imposed on an unsuccessful appellant. Pet. App. 1e. The court concluded that a state statute repealing the penalty was not applicable to this case. *Id.*

I. The Constitutional Attacks On The Punitive Damages Award Were Correctly Rejected On The Basis Of A Valid State Procedural Rule And, In Any Event, Do Not Warrant Further Review.

a. Petitioner has raised a flurry of constitutional attacks on the award of punitive damages, claiming variously that it violates the due process clause, the excessive fines clause, the *ex post facto* clause, the contract clause, and the right of access to the courts. The Alabama Supreme Court did not address any of these arguments; it held that "[r]esolution of these issues would violate a fundamental principle of appellate jurisdiction: that issues not raised before the trial court may not be raised on appeal." Pet. App. 10b.

The law is clear that the failure to observe state procedural rules constitutes an adequate and independent state ground for upholding a judgment. *See, e.g., Michigan v. Tyler*, 436 U.S. 499, 512 n.7 (1978); *Henry v. Mississippi*, 379 U.S. 443, 446 (1965); *New York Times Co. v. Sullivan*, 376 U.S. 254, 264 n.4 (1964). A state, of course, may not simply invent rules to no purpose, but the rule at issue here is longstanding and well-recognized. *See, e.g., Hormel v. Helvering*, 312 U.S. 552, 556 (1941) ("[o]rdinarily an appellate court does not give consideration to issues not raised below"); *Stern v. United States Gypsum, Inc.*, 547 F.2d 1329, 1333 (7th Cir.), *cert. denied*, 434 U.S. 975 (1977). Indeed, a rule requiring the timely raising of claims is necessary to assure an orderly judicial process, and to prevent litigants from using delay and neglect for their own advantage.

Petitioner does not seriously dispute its failure to raise these issues before the trial court--or, for that matter, during the briefing of the original appeal[9]—nor

[9] In the section of its petition headed "The Federal Questions Were Properly Raised," petitioner states that "[i]n its post-trial

could it fairly do so. The record is clear that, in attacking the award of punitive damages, petitioner raised no federal issues whatsoever until it filed for rehearing after the first judgment by the Alabama Supreme Court.[10] Whatever the reason for this belated effort, it was certainly not lack of fair opportunity: in its post-trial motion petitioner managed to raise more than 30 different grounds for setting aside the judgment. Its brief on appeal, as the Alabama Supreme Court noted, raised 11 issues. 469 So.3d at 541.

Petitioner contends that it need not have raised the federal issues in timely fashion because "it has been the rule and practice of Alabama appellate courts to address important constitutional arguments first raised on direct appeal or application for rehearing." Pet. 10. The argument is simply incorrect. Indeed, the very cases cited by petitioner show that Alabama courts strictly apply the rule against hearing arguments first raised on appeal. Pet. 10-11 & n.4.[11] While it is true that those courts,

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motion before the state trial court, and on appeal to the Supreme Court of Alabama, Nationwide argued that the $1.25 million punitive damages award was excessive and the product of unrestrained 'passion and prejudice' on the part of the jury." Pet. 8. If petitioner means to suggest that its argument at that stage was based upon federal law, the suggestion is inaccurate. Petitioner made no argument based upon federal law until after the Alabama Supreme Court had rendered its decision on the original appeal.

[10] Even then, petitioner did not claim that there was any constitutional ceiling on the amount to be awarded. It argued only that application of the bad faith tort to its conduct, which occurred several years before the tort was officially recognized in Alabama, violated the *ex post facto* clause and "the due process clause of the Fifth Amendment." *See* Appendix to Petition for Writ of Certiorari, No. 84-1942, at 91a-92a.

[11] In *State ex rel Knox v. Dillard*, 72 So. 56 (Ala 1916), the defendant *had* raised a challenge to the constitutionality of a statute in the trial court, and the appellate court allowed expansion of that argument on appeal. *See Jaffe Corp. v. Board of Adjustments*, 361 So.2d 556, 560-61 (Ala. Civ. App. 1987) (discussing *Dillard*).

like all other courts of which we are aware, allow for the possibility of hearing such claims to avert blatant injustice, that very limited exception hardly swallows the plain rule. *See, e.g., Green v. Taylor*, 437 So. 2d 1259 (Ala. 1983). Indeed, it would be manifestly unreasonable to put state courts to an all-or-nothing test under which, for this Court to honor their procedural rules, they would be obliged to apply them with total inflexibility or not at all.

The decision in *Hathorn v. Lavorn*, 457 U.S. 255 (1982), relied on by petitioner (Pet. 11), certainly does not require any such choice. The standard set forth in *Hathorn* is merely that state procedural rules be applied "evenhandedly to all similar claims." 457 U.S. at 263. Petitioner has not demonstrated that the Alabama Supreme Court applies its rules randomly, or to favor certain litigants or claims;[12] at most, it has shown that the court may make an exception in exceptional cases. Nor has petitioner offered any mitigating explanation for its failure to raise the federal issues in a timely manner. In the end, therefore, petitioner is in the same boat as many other litigants who disregard procedural rules and later regret it. Such second-thoughts are not reason enough to declare the rules invalid.

In short, the constitutional arguments regarding punitive damages provide no ground for further review. Whether they are meritorious or not, the judgment below

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Here, no course, there was no federal constitutional challenge before the trial court. In every other case cited by petitioner, the appellant had not raised the claim in a timely fashion, and the appellate court refused to consider it. Those cases support the ruling below in this case.

[12] This case plainly does not raise any question of a state court using a procedural rule to discriminate against federal claims. The Alabama Supreme Court applied the same rule to reject arguments based upon state law, that, likewise, had not been raised in the trial court. Pet. App. 8b.

will stand unless this Court also were to hold that the Alabama Supreme Court must hear arguments presented for the first time on appeal. No basis exists for imposing such a rule on state courts, especially when there is no comparable rule for federal courts. The judgment rests upon fully valid state grounds, and, after more than ten years of litigation, this case should be allowed to end.

b. Even if the Alabama Supreme Court had addressed and rejected petitioner's constitutional arguments on their merits, review by this Court would still not be justified. Only the arguments based on the due process and excessive fines clauses have any hint of merit, and those arguments do not fit well with the facts of this case.

The arguments based on other theories can be readily dispensed with. Although petitioner says that the *ex post facto* clause prevents the state courts from retroactively applying the tort of bad faith refusal to pay, it is well recognized that the *ex post facto* clause applies only to penalties that are criminal in nature. *See, e.g., Harisiades v. Shaugnessy*, 342 U.S. 580, 594 (1952). Nor does application of the tort to petitioner violate the contract clause, which has long been held to apply only to legislative acts. *See, e.g., Tidal Oil Co. v. Flanagan*, 263 U.S. 444 (1924).

While the due process clause does place some outer limits on retroactive laws, those limits afford petitioner no help. This Court has said that "legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations. . . . This is true even though the effect of the legislation is to impose a new duty or liability based on past acts." *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 16 (1976). To be unlawful under the due process clause, application of the law, including the decision to make it retroactive, must be without rational basis. *See Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 730

(1984). Here, as in *Usery*, the decision to impose liability for prior conduct is an entirely reasonable judgment that places responsibility on those gaining from the improper conduct and provides benefits to those suffering from it.

The argument based on denial of access to the courts is even more ill-founded. Although petitioner argues that it was only asserting reasonable defenses to a claim for benefits, that view is directly contrary to the facts of the case. The jury below was clearly instructed that it could not impose liability for a bad faith refusal to pay without concluding that the denial was without any reasonable basis. R. 790-792. On review, the Alabama Supreme Court found substantial evidence from which the jury could draw such a conclusion. The premise of petitioner's argument thus is contradicted by the verdict it is meant to attack.

The arguments based upon the due process clause and the excessive fines clause are, at least in theory, more substantial. This Court has recently granted a writ of certiorari to review the question whether an award of $6 million in punitive damages is compatible with these clauses. *See Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*, No. 88-556, certiorari granted, December 5, 1988.[13] There are several distinctions, however, between this case and *Browning-Ferris*.

First, the damages are of a very different order of magnitude: $6 million in *Browning-Ferris* compared to slightly more than $1 million here. Because the question of "excessiveness" is obviously one of degree, the amount of the damages is necessarily relevant in determining whether constitutional boundaries (if any) have been re-

[13] The Court elected not to address the issue in *Bankers Life and Casualty Co. v. Crenshaw*, 108 S.Ct. 1645 (1988), although several Justices indicated their view that the issue was a substantial one. *See id.* at 1654-56 (O'Connor & Scalia, JJ., concurring in part & concurring in the judgment).

spected. No one suggests—indeed, petitioner here expressly disclaims (Pet. 16)—that awards of punitive damages are unconstitutional in and of themselves or that some mathematical formula exists for calculating them. By any standard, an award of $6 million is far more "excessive" than one of $1 million.

Second, the conduct to be punished and deterred is very different. Petitioner and respondent in this case are not two competitors locked in a commercial dispute, as is the case in *Browning-Ferris*. Rather, respondent is a disabled lawyer trying to collect necessary income under a policy purchased from petitioner—the very purpose of which was to provide support should he be unable to work. It is utterly reprehensible for an insurance company, faced with such a claim, to invent a series of false and irrelevant excuses for denial of benefits, leaving persons without income at a time of disability and forcing them to run a constantly revised gauntlet in quest of their rightful benefits. The court below took full account of that behavior by petitioner and concluded that it was deserving of the damages awarded by the jury.

In our view, therefore, the constitutional issues in this case would not merit review by this Court even if they had been properly raised. But the fact remains that they were not properly raised. The Alabama Supreme Court rested its decision solely upon that procedural failure, and its decision to do so raises no issue for this Court to resolve. For the same reason, there is no need to hold the present petition pending the resolution of *Browning-Ferris*: that decision could have no effect on the outcome of this case.

II. There Is No Basis For The Argument That All Judges Hearing The First Appeal Were Disqualified From The Case Upon Remand.

Petitioner makes a separate argument that all judges sitting on the first appeal in this case were barred from

hearing the case upon remand. Pet. 23-25. The sole basis given for this blanket disqualification is that "Justice Embry's participation in the decision-making process infected the entire Alabama Supreme Court with unconstitutional bias." Pet. 24. The argument is without merit.

It must be remembered that, because the case arises out of state court, the issue is one of constitutional standards. To prevail on its argument, therefore, petitioner must establish that the due process clause bars judges from deciding a case that they once decided with a disqualified judge, even though the judges concededly have no personal interest in the case and no independent reason to be anything but impartial. The task is made even more daunting under present circumstances because the judges—to assure that the issues received fresh consideration—insisted upon a complete rebriefing and reargument after remand of the case.

Petitioner cites no authority to support the extreme proposition that judges become "infected . . . with unconstitutional bias." In fact, to the extent any authority exists, it points to the opposite conclusion. In both *Hodosh v. Block Drug Co., Inc.*, 790 F.2d 880 (Fed. Cir. 1986), and *Maier v. Orr*, 758 F.2d 1578 (Fed. Cir. 1985), the Court of Appeals indicated that disqualification of one judge from a three-judge panel would not invalidate the votes of the remaining two judges. In addition, the Advisory Committee on Codes of Judicial Conduct has expressed the view that, when one judge on a panel has been disqualified after discussion but before decision, "the remaining two judges on the panel are not disqualified merely because they conferred with the disqualified judge." *Advisory Opinion No. 71*, Advisory Committee on Codes of Conduct, Judicial Conference of the United States (De-

cember 14, 1981).[14] Even applying the so-called "appearance of impropriety" standard of 28 U.S.C. § 455(a), the Advisory Committee concluded that "no reasonable basis exists for questioning the impartiality of the remaining members when the third recuses, whether that recusal occurs after oral argument or after conference on the case." *Id.* at 2.

Petitioner's argument also ignores the fact that judges are frequently called upon to decide cases without giving weight to extraneous factors. As the Advisory Committee pointed out, "[n]umerous situations arise in which a judge becomes aware of an important fact and yet must proceed to decide without regard to that fact (e.g., inadmissible evidence at trial)." *Id.* at 1. Here, as previously noted, the court below went to great lengths to allow a second presentation of the issues, presumably to guard against any possibility that its decision would be tainted by the prior deliberations. That procedure was more than enough to satisfy due process.

The theory advanced by petitioner ultimately appears to rest upon an overreading of the separate opinions by Justice Blackmun (joined by Justice Marshall) and Justice Brennan in *Aetna Life Ins. Co. v. Lavoie*, *supra*. In those opinions the Justices suggested that, even if Justice Embry had not cast the deciding vote, it might have been appropriate to vacate and remand because the decision-making process was collegial. *See id.* at 1589-90 (Brennan, J., concurring); *id.* at 1590-91 (Blackmun & Marshall, JJ., concurring in the judgment). But the issue before the Court in *Lavoie* was what action this Court should take in the case of a disqualified judge, not what action the state court on remand could take. Had this Court held that only a decisive vote should be nullified,

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[14] The Advisory Committee declined to issue an opinion regarding the proper course once the decision has been handed down, stating that the area was beyond its jurisdiction. *Id.* at 1. In our view, however, there is no persuasive ground on which to distinguish the two situations.

it would have been adopting a conclusive presumption that the other judges *were not affected*, even though those judges had not directly addressed the question themselves. But now that those judges have reconsidered their views, petitioner is seeking to have this Court employ the opposite presumption—that they *were affected*—despite their determination that they were not. There is no good reason to adopt any such presumption at all, much less insist upon it as a matter of due process.

III. The Decision Of The Court Below To Apply The Statutory Affirmance Penalty Is A Matter Of State Law.

The final argument made by petitioner is that the court below was prohibited from imposing a statutory penalty for unsuccessful appeals because the statute was repealed during the appellate proceedings in this case. Pet. 25-26. In petitioner's view, the imposition of the penalty "offends both this Court's order and the law of the case laid down by this Court in vacating the original judgment." Pet. 26.

References to "this Court's order" notwithstanding, this question involves only a matter of state law. Alabama was under no constitutional obligation to repeal its statute, and the effect of that repeal is for the state courts to decide. Nothing in this Court's order purported to control this issue on remand, and petitioner offers no other reason for holding the state court's decision invalid. There is thus no basis for further review.

CONCLUSION

The petition for a writ of certiorari should be denied.

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